August 2, 2013

Shell Energy North America
4445 Eastgate Mall, Suite 100
San Diego, CA 92121
Tel 1+ 858 526 2109
www.shell.com/us/energy

<u>Via E-Mail</u>

Dr. Steven Cliff
Chief, Climate Change Program Evaluation Branch
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Re: Joint Comments of Shell on the July 2013 "Discussion Draft" of Proposed Amendments to the ARB's Cap and Trade Regulations

Dear Dr. Cliff:

Shell Energy North America (US), L.P. ("Shell Energy") and Shell Oil Products US ("SOPUS") (jointly, "Shell") provide the following comments on the Air Resources Board's ("ARB") July 2013 "Discussion Draft" of proposed amendments to the ARB's Cap and Trade Regulations. Shell's comments, which track specific sections of the Regulations, are as follows:

1. <u>Section 95870(e)</u>: Shell supports the Staff proposal to adjust the Industry Assistance Factor in Table 8-1 of the Regulation to 100% for the Second Compliance Period. Shell also supports the ARB's continued efforts to study "trade exposure" to assess possible further adjustments for the Third Compliance Period, as was discussed by Staff at the July 18, 2013 workshop. Shell views these proposed changes as positive steps in reducing the impact of trade exposure on the State's oil refineries and minimizing jobs leakage. These proposed changes are also consistent with other ARB measures to control costs. These benefits will, in turn, enhance stability of the Cap and Trade market and protect consumers from price volatility. Shell notes that all of these proposed benefits will occur while at the same time achieving the proposed emission reductions mandated by AB 32. Moreover, these proposed changes are consistent with objectives of the ARB Scoping Plan.

2. <u>Section 95891</u>: Shell supports the Staff's reference to expected revisions to the Complexity Weighted Tonne (CWT) index that is currently in the Regulation. SOPUS has been working collaboratively with WSPA and the ARB staff in this effort to move from a CWT index to a CWB (Complexity Weighted Barrel) index. CWB is the appropriate index to use for US refineries, where existing measurements and processing equipment are based upon volume as opposed to mass. Conversion to a CWB index is advantageous to refineries because: 1) data quality/reliability using existing metering is ensured; 2) the ability to meet the 5% MRR accuracy requirements can be met; 3) the requirement for additional refinery modifications for adding additional metering is avoided; and 4) added employee safety issues associated with requiring additional sampling of streams for density measurements are avoided.

3. Section 95830(c)(1)(H): Shell does not support the Staff proposal to require an entity that registers with the ARB to identify (and describe) all other entities with which it has a "corporate association." No legitimate purpose would be served by this requirement. The proposed change to the Regulation would impose an unreasonable burden on entities that register with the ARB. For purposes of compliance with the Cap and Trade Regulations, it is enough for an entity to identify all related entities that are "registered" with the ARB, or registered with a "linked" External Greenhouse Gas Emissions Trading System. Inquiry into a direct or indirect corporate association with an entity that is not so registered is neither appropriate nor necessary.

In this connection, many large multi-national corporations have hundreds, if not thousands, of affiliates. It would not be practical, and it would not serve any useful purpose, for a large corporation to disclose all of these entities.

4. Section 95833(a)(1), (2), (3): The purpose of the "corporate association" rules is to place purchasing limits and holding limits on entities that are registered with the ARB (or a "linked" Trading System) and that have a "direct corporate association." No reasonable justification exists to assign a "corporate association" to an entity that is not participating in the Cap and Trade program.

5. Section 95833(a)(2)(F): Although Shell does not object to including limited liability corporations ("LLC") within the meaning of the disclosure rules, it is not enough to establish a "direct corporate association" with an entity by showing that the entity owns more than 50 percent of the LLC. In order to establish the level of "control" that is required for a direct corporate association, the terms of the LLC's operating agreement must be considered. This will be a "subjective" inquiry, but this inquiry is necessary if an LLC is to be included in the consideration of a "direct corporate association."

6. Section 95856(h): The proposed "Compliance Instrument Retirement Order" should be re-written. The Executive Director should only dictate the order in which a covered entity's compliance instruments are retired if the covered entity has not otherwise designated the order in which the instruments are to be retired. For a variety of reasons (including but not limited to corporate taxation and financial accounting), the covered entity may prefer to retire compliance instruments with a more recent vintage ahead of instruments with an older vintage. For example, most companies recognize their free allocations at $0 on their balance sheet, but recognize purchased allowances at "cost." A company may wish to retire all of its freely allocated Vintage 2014 allowances before the company retires its purchased Vintage 2013 allowances, in order to optimize its balance sheet. The proposed Compliance Instrument Retirement Order would not permit this. The order in which a covered entity's compliance instruments are retired should be within the discretion of the covered entity (both for its annual compliance obligation and its triennial compliance obligation). The Executive Director should only prescribe the order of retirement as the "default."

7. Section 95912(d)(4)(C), (D): The proposed rule would require a covered entity's auction participation application to include an allocation of the "purchase limit" and the "holding limit" among members of a "direct corporate association" as defined in Section 95833. Whether or not this proposed rule is adopted, each of the covered entities with a "direct corporate association" that is subject to the purchase limits and the holding limits should be permitted to establish its own subaccount for compliance and retirement in accordance with Section 95856(c), and should be allowed to transfer compliance instruments between and among the compliance accounts for each covered entity, subject to the overall holding limits. This approach provides entities that have a direct corporate association, and that are subject to the purchase and holding limits, greater flexibility in the timing and allocation of compliance instruments for retirement.

8. Section 95920(a): The "holding limit" (for entities with a direct corporate association) referenced in this section of the Rules is unreasonably low. The holding limit fails to take into account the nature of the business in which the covered entity(ies) is/are engaged. Consideration should be given to establishing different holding limits based on the type of business in which the entity is engaged. As the industry gains experience with this market, entities are coming to see how punitive the limits are, especially for companies that have large compliance obligations and/or large purchase commitments by virtue of new or existing contractual arrangements. This latter point (new or existing contractual arrangements) is particularly important, because the limited exemption offered by the Compliance Account does not help an entity that has to transfer large volumes to a third party by virtue of some separate contractual arrangement. For these reasons, the holding limits should be re-examined and increased.

9. Section 95921(b)(3)(C), (4)(E,F,G), (5)(E): The proposed rule would require disclosure of the price term in a transfer request for the sale of compliance instruments, whether the transaction is over-the-counter or an exchange-based agreement. The proposal would require disclosure of a "fixed price" or, in the alternative, a description of the pricing method in the secondary market transaction. In its proposal, the Staff provides no justification for requiring an entity to disclose the price that is agreed upon in a market transaction. The ARB does not approve or regulate the prices of compliance instruments that are sold in secondary market transactions, and the ARB does not regulate or limit the price that an entity may charge to sell, or pay to purchase compliance instruments in the secondary market. Secondary market price regulation is outside the scope of the ARB's authority under AB 32. Mandatory price disclosures are not permissible as a part of a "transfer request."

Furthermore, mandatory price disclosure to the ARB would risk the potential for public disclosure (inadvertent or through a Public Records Act request), which could in turn inhibit or distort competition in the secondary market. The secondary market for compliance instruments can and should be a robust and competitive market. Price disclosure could have a chilling effect on secondary market transactions.

In this connection, a "liquid" secondary market is dependent on a large volume of trades. Requiring price disclosure for secondary market transactions would reduce liquidity and create conditions that would make price manipulation relatively more likely. The Staff attempts to justify a price disclosure requirement for secondary market transactions based on a concern about price manipulation. In fact, a mandatory price disclosure requirement could lead to reduced liquidity, creating a greater potential for market manipulation.

In addition, some of the compliance instruments that will be purchased and sold in the secondary market represent "offsets," as well as allowances from jurisdictions (e.g., Quebec) with which the Cap and Trade program is "linked." There is a serious question whether the ARB can legally demand disclosure of prices agreed upon in transactions that occur outside California.

Finally, because the ARB does not <u>regulate</u> secondary market prices for compliance instruments, no legitimate purpose would be served by having the ARB demand price disclosure as a part of a transfer request. The ARB has a valid reason for requiring the disclosure of information regarding transaction dates, quantities and products transferred. Price, however, is not within the ARB's authority. The Staff proposal offers no reasonable justification for requesting price information. Price disclosure should not be required.

10. <u>Section 95985(i)</u>: The Staff proposes to delete this subsection, which heretofore addressed the requirements for replacement of ARB offset credits for forest offset projects in the event that the offset credits are determined to be invalid. As currently written, the subsection imposes the obligation to replace the ARB offset credits on the "Forest Owner" if the offset credit is determined to be invalid after retirement of the offset. Entities have relied upon this provision in the negotiation and execution of contracts for the purchase of offsets, and in the allocation of costs and risks under those contracts. The Staff's proposed change would shift responsibility for "replacement" of offset credits from the Forest Owner to the purchaser of the offset credit, thereby undermining the terms of existing contracts.

The Staff has not adequately explained why this subsection should be deleted. The subsection provides a clear, understandable assignment of responsibility in the event an offset credit from a forestry project is deemed to be invalid. Reversing direction with respect to the assignment of liability will create uncertainty and will be disruptive to entities with existing contracts.

If the ARB decides to adopt the Staff's recommendation to delete this subsection, the ARB must adopt accompanying rules that afford "grandfathered" treatment to contracts that pre-date the effective date of the new rules. Parties that relied upon the pre-existing rules at the time they entered into their agreement for the purchase and sale of forest project offsets should continue to be able to rely upon these pre-existing rules for the duration of their contract.

11. Sections 95891(f), 95894: These sections address the "Transition Assistance" (direct allocation of allowances) that the Staff proposes for eligible "legacy contract" generators. During the workshop, a proposal was advanced that would provide an "adjustment" to the direct allocation of allowances in the amount of the emissions associated with "energy purchases." This proposal needs further clarification. If the "adjustment" negates the ability of some legacy contract generators to obtain a direct allocation of allowances, the purpose of the Transition Assistance provision would be defeated. Further clarification regarding the "adjustment" for emissions associated with "energy purchases" should be clarified in order to provide parties with the ability to properly address the proposal in comments.

As a general matter, under the Transition Assistance proposal, the direct allocation of allowances should be available to all otherwise eligible legacy contracts. In addition, the ARB should include language in the Regulation to reflect Staff's workshop comments that parties to a legacy contract, after a determination of eligibility, should continue to be eligible for the proposed Transition Assistance whether or not contract renegotiation can be achieved. Parties to an otherwise eligible legacy contract should not be discouraged from renegotiating their contract based on the potential for the loss of a direct allocation of allowances.

Shell appreciates the opportunity to provide these joint comments on the proposed amendments to the Cap and Trade Regulations. If Staff has any questions regarding these comments, Shell would be pleased to discuss the concerns raised in these comments in greater detail.

Respectfully submitted,

MAMilner

Marcie A. Milner
Vice President, Regulatory Affairs
Shell Energy North America (US), L.P.
4445 Eastgate Mall, Suite 100
San Diego, CA 92121
Phone: 858.526.2106
Fax: 858.320.2606

On behalf of Shell Energy and SOPUS